

WHAT WILL OUR MONEY BE GOOD FOR AFTER THE WAR?

If a group of business men or bankers had asked me the question which you have invited me to discuss this evening, I would have suspected nothing. But coming from this learned body in which there are so many who could answer this question better than I can, it makes me think of those innocent looking questions we sometimes find in examinations -- questions that look easy but are full of pitfalls for the unwary. For the fact of the matter is that nobody can answer this question with any degree of assurance. There is nothing in all of your philosophy or science that can tell us with any certainty what money will be worth at sometime in the future. And you all know that quite as well as I do. All that any of us can do is to consider the many factors, interrelated and complicated as they undoubtedly are, that have a bearing on the question.

Not long ago I had a letter from a man whom I do not know, who had just been advised by his doctors that he had but a short time to live. He wanted advice as to how best to invest his savings for the benefit of his family. He wished to have the money available in ten or twelve years. Ordinarily, I would not venture to offer advice to an individual, but his letter was pathetic and appealing. I assured him that he could dismiss from his mind any fear that the Government would repudiate its obligations, since that could only happen if our entire system, governmental and financial, were to collapse completely. Of course in such an extremity no investment in the country would be of value.

In advising him that, in my judgment, Government bonds were the safest available investment for his life savings, I wrote him substantially as follows: No one can forecast with any certainty what the purchasing power of the dollar will be ten or twelve years from now. That depends on too many unpredictable factors. It

depends primarily upon whether our people as a whole sufficiently understand economic conditions and forces to support Government policies and actions which will minimize either inflationary or deflationary trends, for both are equally destructive. By Government, I mean the Congress and whatever administration may be in power.

Informed men will have no difficulty in telling what the trends are and what needs to be done to prevent them from getting out of hand. The question will be whether wise counsels will prevail. I can see no justification under modern conditions for the assumption that our economic swings are self-adjusting, except possibly after such violence as to jeopardize and frequently to destroy our savings, <sup>not our future</sup> Nor do I think that by individual action, business alone or the public generally pursuing individual interests, can maintain, for long at least, economic stability. Rather, I am convinced that the Government, as the collective agent of all of us, is the only medium through which counteraction can be undertaken to moderate economic extremes. That being so, the question which no one can answer now is whether the Government in the future will be able properly and wisely to exercise its undoubted powers to preserve a reasonable degree of stability.

We all know that the war has necessarily limited the supply of goods and services available for civilian consumption, although the volume over-all has not actually been curtailed. We all know that an unprecedented and wholly disproportionate amount of purchasing power has been created by the manner in which we have financed the war -- a volume of purchasing power that if it were to be turned loose now or in the <sup>early</sup> postwar period would drive prices up to destructively high inflationary levels. ~~It has long been my view, and still is, that we have not managed the war financing nearly as well as other democratic countries have, largely because we have failed to impose sufficient taxes in such a way as to reduce inflationary factors.~~

Nevertheless, the tremendously excessive buying power that has been generated and remains a dangerous inflationary potential has not taken effect ~~in it~~, as yet ~~any~~, to any large degree. Whether before the war ends or shortly thereafter this inflationary potential will break through price ceilings and the restraints that have been imposed from the top, rather than through drawing off surplus buying power at the bottom, is one of the unpredictable factors. I would not care to venture any public prediction. But if I were obliged to hazard a guess, I would say that I would expect some further gradual, and I hope very moderate, increases in prices but not a runaway inflation. Much depends, of course, on how long the war continues and on how our people use their funds, That is to say, upon human behavior. ~~These likewise~~  
~~largely matters of guesswork.~~

That, in substance, is what I said in general terms in answer to much the same question which you have posed.

The answer may be stated briefly in another way. As Walter Lippmann recently put it, "The real economic consequences of war depend upon how soon and how completely the productive capacity of the nation can be restored to civilian use and then maintained." And he added, "If we fix our minds upon the fact that the capacity to produce is the nation's wealth and upon the dislocation of that capacity as the supreme evil to be avoided, we shall, I believe, have hold of the saving truth. This is not the economics we were taught in school, but it is the economics we are going to have to learn in order to live in this century."

Certainly the war should have taught us, if we had not learned before, that the nation's capacity to produce is our real wealth. Our dollars are but symbols of or claims upon that wealth. They will be worth much or little, depending upon how much of that real wealth they will purchase.

Let us look for a few moments at the main factors which will determine the

stability of the purchasing power of our dollars in the years ahead. Proper fiscal policies are the most effective means of combating either inflation or deflation. The tax instrument is by far the most powerful single weapon in the Government's arsenal. Taxation is never neutral in its economic effects, and particularly since the war it has been more and more widely recognized that even if levied ostensibly for revenue only, taxes have a direct influence on those basic factors of consumption, savings and investment<sup>1</sup> which, by getting out of balance, produce economic ups and downs.

By using the instrument of fiscal policy wisely, much can be done to keep these basic factors in reasonable balance. The real question before us is: What type and what amount of taxation will best help to keep the economy moving ahead on an even keel when the war ends and looking to the longer future? Under war conditions and in the immediate aftermath, until industry is <sup>largely</sup> ~~fully~~ reconverted to peacetime production, the inflationary potential will be the dominant economic force with which we must deal, although in the early postwar years we will have a combination of inflationary and deflationary forces. Looking further ahead, however, deflationary forces, which continued to dominate our economy until the war, are certain to reappear.

I hesitate even to touch on so burning a subject as wartime taxation, but we must realize that the chances of dealing successfully with inflationary forces now and in the aftermath of the war would be vastly improved if we had the will to tax back into the stream of war expenditures a far larger amount than we have been raising or are apparently prepared to raise by revenue measures. Compared with our principal Allies, we have not made a very good showing either in taxing sufficiently or in borrowing sufficiently outside of the banking system. Borrowing from the commercial banks and the Reserve Banks not only fails to absorb excessive existing funds, but creates fresh money supplies on top of an already vastly swollen total. Our money supply today, consisting of demand deposits and currency, exceeds 80 billions, or nearly twice as much as it was only two years ago. At the rate we have been going, it

will continue to expand as long as the war continues. To this must be added over 30 billion dollars of time deposits and the many billions of U. S. Government securities held by the public. This huge and growing volume of liquid funds is the basis for the inflationary problem in the transition period.

A speedy conversion to peacetime production is the most direct and effective way to cope with the inflation problem. On industry's part, this requires advance planning for the return to an expanded production so that a high level of employment can be maintained with the least possible interruption. It is important that the expansion of industry should be only in those fields where it is justified by the promise of a permanent market. Expansion should be avoided where it would merely serve to meet a temporary high level of demand arising from the huge backlog of deferred purchases. This backlog should be met gradually. Otherwise, excess capacity while it was being created would accentuate the inflation danger during the transition period and the danger of deflation later on. On the Government's part, an orderly and ~~expeditious~~ expeditious transition requires the setting up of effective machinery for the prompt termination and payment of amounts due on outstanding contracts, for the disposition of inventories and Government-owned facilities needed in peacetime production and for assuring an ample credit supply. If claims against outstanding Government contracts are settled promptly, the credit position of business on the whole will be very strong. However, there are a few large enterprises and many small businesses which will be in need of funds, either in the form of credit, equity capital, or both. All necessary steps should be taken to assure that these needs will be met. The funds should be supplied as far as possible from private sources with such Government assistance as may be required.



Even though we may succeed in resuming peacetime production rapidly, there will still be a period of heavy inflationary pressures due to the desire of consumers to satisfy their deferred demands, and the requirements of business for supplies to take care of deferred maintenance and improvements and to restock inventories. Heavy export demands will also continue. It is most important that prices be held from the outset and that the public be confident of this policy. We must give assurance to the millions of bondholders that they will not lose by delaying their purchases until ample supplies are again available. If wartime savings are used gradually after industry has returned to a peacetime basis, they can contribute greatly to the maintenance of prosperity. But if spent too rapidly, the savings would be dissipated in higher prices and would undermine the foundations of the economy.

There can be no doubt, therefore, that inflation controls should be maintained during this transition period. Continued rationing and price controls will be needed in the domestic market, and licensing control of exports should be retained. Wartime taxes should be kept up, including the excess profits tax, although it may be desirable to reduce the present 95 per cent rate to, say, 75 per cent, in order to encourage efficiency, economy and increased production. The drastic reduction of expenditures which will take place will not justify a premature reduction of taxes. On the contrary, every attempt should be made to bring about a balanced budget at the earliest possible date after the war. It is unlikely that the public will be absorbing additional Government securities during that period, but will be tending to sell on balance some of its holdings. Unless the budget is balanced, the banks would not only have to absorb possible sales by nonbank holders, but would also have to absorb the new issues needed to finance the deficit, thus aggravating the inflationary situation by further increasing the already excessive supply of money. A balanced budget,

on the other hand, will encourage the owners of Government bonds to retain their holdings because it will assure them that the purchasing power of their money, invested in bonds, will be preserved.

After the war is won and industry has been fully readjusted to a peacetime basis, American enterprise will meet its greatest challenge, namely, to provide peacetime production on a scale commensurate with the enormous ability to produce which our economy has demonstrated during the war years. This will mean the employment of at least 55 million people, as compared with 46 million in 1940, when more people were employed than in any previous year. At 1943 prices, this means a gross national product of about 160 billion dollars, or close to 45 billion dollars more than in 1940.

To meet this challenge, we must realize that a high level of employment and income requires a high level of expenditures, private or public. We have seen during the war years how greatly our national product can be increased if there is sufficient demand for the country's output. After the transition has been made, we shall be able to maintain a high level of output only if a vast increase in peacetime expenditures replaces a large part of the war outlays. Business will not be able to supply a product of 160 billion dollars unless there is a corresponding demand by the economy as a whole. Demand will not be sufficient unless business distributes its income to the people, and unless the people return their incomes to enterprise in the purchase of its goods and services. This means, first of all, maintenance of a high volume of wages. The aggregate of buying power must be maintained, although some wages may have to be adjusted downward and others upward. This buying power must then be returned to the economy through a high level of consumption expenditures. Of course, not all income will be spent on consumption. There will be savings both by individuals and by business enterprises. We can have saving and a high level of income and employment if the savings are invested in the improvement and expansion of our economy.

When savings are thus spent upon the production of new facilities of all kinds, they provide income and employment. But when savings are held idle, or used to bid up the prices of existing assets, they are not returned to production and other dollars must take their place if employment is to be maintained. The basic condition for economic prosperity is thus a steady stream of consumer, business and public expenditures at a volume sufficient to employ all who desire to work. The more fully private enterprise succeeds in providing the necessary volume of income and expenditures, the less necessary it will be for Government -- Federal, State and local -- to provide supplementary employment.

The contribution which monetary policy can make to the goal of maximum production and employment is limited. The banking system and the capital market must provide adequate funds to meet the credit and capital needs of the country. Merely making funds available, however low the cost, will not induce expansion unless business is assured of a market for its increased production. On the other hand, the impact of fiscal policies on the spending stream is far more direct and powerful. Revenue measures and public expenditures can either increase or decrease the income stream. The Government can so shape and time its tax and expenditure policies as to offset variations in the income stream due to variations in the volume of private expenditures. By wise policy, correctly timed, Government can thus be a balance wheel and a stabilizing influence in helping to maintain a high level of production and employment. Taxation, therefore, has become much more than a problem merely of meeting the fiscal needs of the Treasury. It is also a major concern of national economic policy.

There is much discussion currently about incentive taxation, as if it were a panacea. Every taxpayer, individual or corporate, is inclined to think that the best incentive would be to reduce his own taxes. Thus, the argument for tax incentives



readily develops into an argument for greatly reduced taxes for everybody. Greatly reducing everybody's taxes, however, is not the way to maintain a balanced budget, as we certainly should do when we have a high level of employment. It is likely that the Federal postwar budget will be well above 20 billion dollars annually. Therefore, wholesale tax reductions are out of the question if we are to maintain a balanced budget, and such tax reductions as we can afford must be applied in a way that will contribute most to the maintenance of employment.

The question is not so much one of incentives as of objectives. If we are to have a high level of national income, then, as I have indicated, we must have a high level of consumption outlays. The most important consideration, therefore, is that taxes should interfere as little as possible with the flow of consumer expenditures. The first step towards this end is to reduce indirect taxes on consumption and, if necessary, to substitute direct taxes on income. Indirect taxes are added to the price which the consumer must pay. The greater the sales tax, the fewer goods the customer can buy, and the less he can buy, the less the business man can sell. That, in turn, means less employment. At the same time, sales taxes penalize those who consume a large share of their income. There is thus a strong case for a drastic reduction in Federal sales and excise taxes just as soon as the supply of consumer goods on the whole begins to exceed the demand. This condition is not likely to be reached until the backlog of deferred consumer demand has been met. The personal income tax should be the main source of Federal revenue in the postwar period because it is the most flexible and equitable type of taxation, and because consumption is less affected by it.

Another important step in maintaining the flow of consumption expenditures would be to expand the social security program, including unemployment insurance, provision for old age, disability and other hazards. Coverage should be broadened, payments

liberalized, and in the case of unemployment insurance, the period of payment should be lengthened. Providing an adequate old-age pension and extending it to cover everyone would enable a great many more people to retire, and this will assist in meeting the unemployment problem. Through provisions of this kind, a feeling of security is given to people generally and they are thus put in a position where they will feel free to spend a larger share of their current income, thereby contributing to the maintenance of employment.

Postwar tax policy will also have to be concerned with the flow of capital expenditures. In much of the current discussion, the deterrent effects of taxation upon business spending are exaggerated. Low taxes on business will not bring about a high level of capital expenditures if the demand for the products of business does not justify such expenditures. If demand does justify the expenditures, even high taxes will not keep businesses from expanding to meet the demand, unless they are subject to excessively high tax rates. The existence of markets for their products, rather than taxation, is the decisive factor, particularly in the case of large and well established enterprises, such as those in the steel, oil, automobile and chemical industries, among others. Present corporation tax laws have given considerable postwar protection to those concerns which have made excess profits by providing a postwar credit of 10 per cent of their excess profits tax, as well as a provision for the carry-back and carry-forward for two years of unused excess profits credits and of net operating losses. This is a tax incentive to business which already exists.

The effect of taxes on many of the small enterprises and on the establishment of new enterprises is another matter and needs to be given particular consideration. Perhaps the most important tax deterrent results from the fact that income is taxable under the corporation income tax, and it is again taxable under the personal income tax when it is distributed as dividends to the owners. This procedure has a number of harmful results. It places a premium on fixed debt financing and a penalty upon equity

capital since the corporation may deduct interest as a cost item in computing its taxable income, while no such deduction is allowed for the return to stockholders on equity capital. It would greatly help to secure a less vulnerable business structure if more financing were done with equity capital and less with debt forms. Because of the existing situation, investors are reluctant to supply equity funds, particularly to small and new enterprises which are more risky than the larger, well-established enterprises. The personal income taxes upon dividends, particularly when subject to the higher surtaxes, are an inducement to stockholders with large incomes, who influence corporation policies, to prevent distribution of corporate earnings. This situation is likely to be detrimental to the maintenance of employment because corporations are thus led to retain earnings beyond what is needed and, therefore, they are not returned to the spending stream.

Equity investment and the distribution of corporate earnings would be greatly encouraged by adopting a plan somewhat similar to the British method of dealing with dividend income. One effective method would be to give a tax credit to the person who receives the dividends. A tax would be collected from the corporation as now, but when dividends are distributed, the stockholder would be permitted to take a credit on his personal income tax of some substantial fixed percentage of his dividend income. Another method would be to give the corporation a similar fixed percentage credit for that portion of its earnings which it distributes to stockholders. Either method would greatly reduce the amount of double taxation on equity capital and would be a strong incentive to new equity investments.

We should consider whether it would help in stabilizing the business structure to continue some form of excess profits tax, together with liberal provision for carry-forward and carry-back of the excess profits tax credit, and also make more liberal provision for carrying forward and carrying back losses than is now made in the tax law. Such provisions would be particularly helpful to small and new

enterprises. We must encourage the establishment of new enterprises and safeguard the great number of existing small enterprises if we are to obtain a flexible and competitive business structure and halt the movement tending toward increasingly large combines and monopolies. Another most important step in this connection would be the establishment of patent pools freely available to small and new enterprises as well as to others.

Our postwar tax structure must be flexible and adaptable to the changing requirements of fiscal policy. Tax policy must be recognized as part of a flexible fiscal system and should be used to supplement or curtail the flow of consumer and business spending as conditions require. Our fundamental purpose must be to avoid either inflation or deflation -- in other words, our objective must be full and sustained production and employment.

What our dollar will be worth in the end will depend on what the economy can produce. We must avoid an inflated dollar, for it is a dollar that buys less and less. We must avoid a deflated dollar for while it will buy more, it is a disaster dollar based on human misery and distress. What we seek, surely, is a healthy and progressing economy, with a steadily rising standard of living for all.

Perhaps our question should be not "What will our money be good for after the war?", but "What goods will our money buy after the war and in the future?". It is the goods that our economy can produce and that our dollars can buy which will create an infinitely better standard of living for all of our people than we have ever known. There is no good reason why we cannot achieve in peace as full a use of our manpower and materials as we do in war. War production is a miracle, beyond our greatest expectations. Peacetime production can be equally miraculous if we will make our money system the servant, not the master, of our capacity to produce.